

VIA ELECTRONIC MAIL

October 30, 2008

Fred Wong  
Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Room N-5655  
U.S. Department of Labor  
200 Constitution Ave. N.W.  
Washington, D.C. 20210

RE: Investment Advice – Participants and Beneficiaries (“Proposed Regulation”); and Proposed Class Exemption for the Provision of Investment Advice to Participants and Beneficiaries of Self-Directed Individual Account Plans and IRAs (“Proposed Class Exemption”)

Dear Mr. Wong:

The Financial Services Institute (FSI)<sup>1</sup> appreciates this opportunity to comment on the above-referenced Proposed Regulation and Proposed Class Exemption (collectively, the “Proposals”) published in the *Federal Register* by the Department of Labor Employee Benefits Security Administration (the “Department”) on August 22, 2008.<sup>2</sup> FSI applauds the Department’s efforts and its recognition of the importance of professional investment advice for participants and beneficiaries of self-directed individual account plans and IRAs. Recent turmoil in the financial markets further underscores this need. However, if the Proposals are adopted in their current form, financial services firms will be required to undertake significant and challenging operational changes and will be subject to substantial regulatory overlap. Given that the stated objective of the Proposals is to increase access to professional investment advice, and because our member firms are subject to well-developed regulatory and reporting procedures, FSI strongly suggests that it is in the best interests of affected participants and beneficiaries to ensure that the proposals can be implemented in a manner consistent with preexisting securities regulations.

#### Background on FSI Members

The Proposals are of particular interest to FSI members. The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD members also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients’ financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and

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<sup>1</sup> The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 118 Broker-Dealer member firms that have more than 144,000 affiliated registered representatives serving more than 15 million American households. FSI also has more than 12,000 Financial Advisor members.

<sup>2</sup> See 73 FR 49896 at

<http://www.dol.gov/federalregister/HtmlDisplay.aspx?DocId=21243&AgencyId=8&DocumentType=1>.

their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 98,000 independent financial advisors – or approximately 42.3% percent of all practicing registered representatives – operate in the IBD channel.<sup>3</sup> These financial advisors are self-employed independent contractors, rather than employees of the IBD firms. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically “Main Street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.<sup>4</sup> Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients’ investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI’s primary goal is to insure our members operate in a regulatory environment that is fair and balanced. FSI’s advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

#### Comments

The Proposed Regulation and Class Exemption are of particular interest to FSI. While FSI is generally supportive of the Department’s efforts, we respectfully request certain clarifications. Specifically, we offer the following comments for your consideration:

- Clarify the Extent to which the Enumerated Factors Must be Considered and/or Extend the Exemptions to Reflect Existing Suitability Standards – FSI seeks clarification with respect to the information a fiduciary adviser is required to obtain and consider in making recommendations to clients concerning their individual account plans. FSI urges the Department to avoid conditions that result in inconsistent regulatory requirements and adopt a standard that is consistent with existing securities regulations. Pursuant to existing regulations, the Financial Industry Regulatory Authority (“FINRA”) requires registered representatives of broker-dealers to have reasonable grounds for believing that their recommendations are suitable based upon the facts disclosed by the customer,

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<sup>3</sup> Cerulli Associates Quantitative Update: Advisor Metrics 2007, Exhibit 2.04. Please note that this figure represents a subset of independent contractor financial advisors. In fact, more than 138,000 financial advisors are affiliated with FSI member firms. Cerulli Associates categorizes the majority of these additional advisors as part of the bank or insurance channel.

<sup>4</sup> These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisors.

including outside investments, financial situation and needs.<sup>5</sup> Registered representatives are also required to make reasonable efforts to obtain information concerning their customer's financial status, tax status, investment objectives, and other information considered reasonable by the representative making the recommendation.<sup>6</sup> Registered investment advisers ("RIAs") and their investment adviser representatives ("IARs") are subject to regulation and oversight by the Securities and Exchange Commission ("SEC") and are governed by the Investment Advisers Act of 1940. IARs must make recommendations that are prudent and in the best interest of their clients, and therefore, must consider the suitability of recommendations in light of the client's overall financial situation and investment objectives.<sup>7</sup> Both broker-dealers and investment advisers are subject to periodic audits of internal procedures and controls.<sup>8</sup>

Section III(b) and (c) of the Proposed Class Exemption and Sections (c)(12)(ii) and (d)(1)(ii) of the Proposed Regulations require, as a condition of the prohibited transaction exemption, that the investment advice take into account information furnished by a participant or beneficiary relating to age, life expectancy, retirement age, risk tolerance, other assets or sources of income and investment preferences. A fiduciary adviser is also required to undertake reasonable efforts to obtain information relating to the customer's financial status, tax status, investment objectives, age, employment status, annual income, prior investment experience, investment time horizon, risk tolerance, etc. In our experience, some clients are reluctant or unwilling to divulge certain personal information. In addition, some of the information that would be required by the Proposals may be difficult to ascertain. To the extent the Department intends that each of the aforementioned factors must be considered, FSI submits that such an analysis goes well beyond existing regulatory standards. As one specific example, neither the SEC nor FINRA require a fiduciary adviser to solicit information relating to the life expectancy of a client. It is difficult to imagine how an adviser would obtain such information and even more difficult to conceive of a method to supervise such an analysis. FSI urges the Department to consider adopting a standard for fiduciary advisers that is consistent with the fiduciary adviser's existing regulatory requirements. Absent such clarification, broker-dealer and RIA firms will be reluctant to allow their investment professionals to advise affected participants, and the Department's stated objectives will be less likely to be achieved.

- Clarify the Fiduciary Adviser's Ability to Perform Periodic Rebalancing of Accounts – The Department has correctly recognized that plan participants and IRA accounts holders are likely to achieve improved investment returns when they receive quality investment advice from qualified individuals and firms. Specifically, the Department states that "[i]n theory, investors can optimize their investment mix over time to match their investment horizon and personal taste for risk and return..." Paragraph (h)(2) of the Proposed Regulation and Section III(k) of the Proposed Class Exemption, however, may unintentionally interfere with the implementation of an optimized investment strategy by

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<sup>5</sup> See NASD Rule 2310(a) at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=3638](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3638).

<sup>6</sup> See NASD Rule 2310(b) at [http://finra.complinet.com/en/display/display\\_main.html?rbid=2403&element\\_id=3638](http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=3638).

<sup>7</sup> See Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 84 S. Ct. 275, 11 L. Ed. 2d 237 (1963) and See In re John G. Kinnard and Co., SEC No-Action Letter, 1973 WL 11848, Fed. Sec. L. Rep. (CCH) ¶79,662 (Nov. 30, 1973).

<sup>8</sup> Broker-dealer audits are performed by state securities divisions, FINRA, and the SEC. Investment advisers are subject to audit from state securities divisions or the SEC depending upon, among other things, the value of the assets under the adviser's management.

requiring that “[t]he sale, acquisition, or holding occurs solely at the direction of the recipient of the advice.” FSI is concerned that these provisions may prohibit fiduciary advisers and their clients from taking advantage of the many existing investment advice programs that offer automatic rebalancing of account holdings at specified intervals. Such programs allow the client to authorize periodic (e.g., quarterly or annually) rebalancing of the account according to predetermined asset allocation percentages. Automatic rebalancing seeks to maintain the optimum percentage allocation of the portfolio within the predetermined asset classes selected by the client. The programs are non-discretionary in that the advisor must adhere to the investment options and allocations selected by the client. Given that such programs seek to maintain the client’s chosen investment strategy, FSI seeks clarification from the Department that the client’s authorization to participate in an account-rebalancing program will meet the requirements of the Proposals.

- Consider Extending the Exemption for Computer Modeling in IRAs to Other Plans with Numerous Investment Choices – As the Department correctly points out, the conditioning of relief on the deployment of specific, model generated investment recommendations may be neither practical nor effective as applied to IRAs. Section III(e)(2) of the Proposed Class Exemption, therefore, provides alternatives for relief when the type or number of investment choices reasonably precludes the use of a computer model. FSI submits that such alternatives should be extended to apply to plan participants and beneficiaries with access to a wide array of investment options, such as those plans with open brokerage windows. Given that the aforementioned challenges that apply to computer models within the context of IRAs are equally present in self-directed individual account plans, extending the relief contained in Section III(e)(2) to these plans would serve to increase the availability of professional investment advice to participants and beneficiaries.
- Consider Adding a Materiality Requirement to the Audit Requirements and Limiting the Scope of the Provisions for Patterns of Noncompliance – As proposed, both the Proposed Regulation and the Proposed Class Exemption require the independent auditor to furnish a written report to each fiduciary who authorized the arrangement or to all beneficiaries of the subject IRA. The scope of the report is well defined in that the auditor must set forth specific findings regarding compliance with the enumerated requirements of the Proposals. Notably absent from the Proposals, however, is any opportunity to cure immaterial violations on the part of the fiduciary adviser. Given the current regulatory and litigation environment, FSI is concerned that many firms will be discouraged by such requirements, as they seek to limit areas of potential negative publicity and exposure. The result will necessarily be decreased availability of professional investment advice. Adopting a materiality standard and procedure for curing immaterial violations would serve to encourage timely efforts to amend those policies and procedures that are deemed to be non-compliant and would be consistent with IBD firms experience with the SEC and FINRA as they relate to the reporting of violations deemed to be immaterial and not harmful to investors.<sup>9</sup>

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<sup>9</sup> For example, Rule 206(4)-7, Section 203(e)(5) of the Advisers Act has for some time contained a “safe harbor” for investment advisers and supervisors from SEC sanctions for “failure to supervise” if: (a) The adviser establishes procedures that would reasonably be expected to prevent and detect violations of the federal securities laws; (b) The adviser has in place a system for applying the procedures; (c) The supervisor has reasonably discharged his or her supervisory responsibilities; and (d) The supervisor has no reason to believe the person was not complying with the procedures and system. NASD Conduct Rule 3010 has historically been interpreted in similar fashion.

Additionally, Section V of the Proposed Class Exemption seeks to withdraw the applicability of the exemption for advice delivered during a time in which a pattern of non-compliance is deemed to have existed. FSI is concerned with the scope of the penalty for non-compliance insofar as it relates to the fiduciary adviser firm. For example, many member firms seek to deploy hundreds of fiduciary advisers who would operate under a common entity. Given the fact that, as currently proposed, a pattern of non-compliance on the part of a single adviser could give rise to prohibited transactions for all of the firm's fiduciary adviser clients, FSI believes that many firms will be reluctant to enter the marketplace, as the potential exposure could dwarf any anticipated benefits. Consequently, in order to increase the number of firms offering fiduciary advice, and thus the availability of professional investment advice to participants and beneficiaries, FSI urges the Department to clarify the scope of the aforementioned penalty for non-compliance and consider limiting the same to the individual fiduciary adviser deemed to exhibit a pattern of non-compliance.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with the Department to achieve further efficiency while maintaining investor protection. Thank you for your consideration of our comments. Should you have any questions, please contact me at 770 980-8487.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Dale Brown", written in a cursive style.

Dale E. Brown, CAE  
President & CEO